

June 20, 2005

To the Citizens of Redmond, Washington:

The Comprehensive Annual Financial Report of the City of Redmond for the fiscal year ended December 31, 2004, is submitted herewith. We believe the information, as presented, is accurate in all material aspects; that it is presented in a manner designed to set forth fairly the financial position and results of operations of the City as measured and reported by the financial activity of its various funds; and that all disclosures necessary to enable the reader to gain an adequate understanding of the City's financial affairs have been included. Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, including all disclosures, rests with city management.

The report was prepared by the City's Finance Department in accordance with generally accepted accounting principles (GAAP) and is intended to provide sufficient information to permit the assessment of stewardship and accountability, to demonstrate legal compliance, and to provide management control.

The report includes all funds, account groups, agencies, and boards and commissions that are controlled by, or dependent on, the City's executive and legislative departments. Included as part of the reporting entity is the Redmond Public Corporation, over which the City Council has control.

Cities and counties of the State of Washington must comply with the Budgeting, Accounting and Reporting System (BARS) prescribed by the Office of the State Auditor. State law also provides for an annual independent audit by the Office of the State Auditor and requires timely submission of annual financial reports to the State for review.

As a recipient of federal, state, and county financial assistance the City is required to undergo an annual single audit in conformity with the provisions of the Single Audit Act Amendments of 1996 and Budget Circular A-133, *Audits of State and Local Governments*. This audit is conducted by the State Auditor's Office in conjunction with the City's annual independent audit. The results of the City's single annual audit for the fiscal year ended December 31, 2004 provided no instances of material

weaknesses in the internal control structure or significant violations of applicable laws and regulations.

In developing and evaluating the City's accounting control system, consideration is given to the adequacy of internal accounting controls. Accounting control comprises the plan of organization and procedures and records that are concerned with the safeguarding of assets and the reliability of financial records and consequently are designed to provide reasonable assurance that:

Transactions are executed in accordance with management's general or specific authorization.

Transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with GAAP, or any other criteria, such as finance-related legal and contractual compliance requirements applicable to such statements, and (2) to maintain accountability for assets.

Access to assets is permitted only in accordance with management's authorization.

The recorded accountability for assets is compared with existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

The definition of accounting control assumes reasonable, but not absolute, assurance that the objectives expressed in it will be accomplished by the system. The concept of reasonable assurance recognizes that the cost of internal control should not exceed the benefits expected to be derived.

We believe that the City's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

GAAP requires that management provide a narrative introduction, overview and analysis to accompany the basic financial statements in the form of *Management's Discussion and Analysis (MD&A)*. This letter of transmittal is designed to complement the MD&A and

should be read in conjunction with it. The City of Redmond's MD&A can be found immediately following the independent auditor's report.

Profile of the Government

Redmond is a non-charter code city, operating under Section 35A of the Revised Code of Washington. It has a Mayor/Council form of government. The Mayor and the seven member City Council are elected for staggered four-year terms and are elected at-large, rather than by district. Members of the City Council are responsible for establishing the general direction and policies for the City and for providing the resources necessary to carry out those policies. As the City's chief administrator, the Mayor is responsible for carrying out the policy and direction set by the City Council. This includes the enforcement of laws and ordinances, the execution of contracts and agreements, and maintenance of peace and order in the city.

The City of Redmond provides a full range of municipal services, including police and fire, emergency medical services, planning and zoning, street maintenance and construction, parks and recreation, and general administrative services. The City operates enterprise funds for water and wastewater services and stormwater management.

The City prepares budgets on the modified accrual basis in accordance with the Revised Code of Washington (RCW) 35A.33. Biennial budgets are adopted by the City Council for funds providing customary government services. Each biennium begins with an odd numbered year. Reviews are conducted at mid-biennium and any changes for the second half of the biennium are adopted by the City Council.

The LID Control and LID Guaranty Debt Service Funds and custodial agency funds, however, are not budgeted. Enterprise and internal service fund budgets are for management control only and are, therefore, not included in this report.

A budget increase or decrease to a fund must be authorized by the City Council, while appropriation changes within a fund may be authorized by the Mayor. All budgets are controlled on a departmental basis. Estimated purchase order amounts are encumbered prior to the release of the order to the supplier. Such encumbrances also serve to provide an additional measure of budgetary control. Open encumbrances are canceled at

the end of the biennium and must be reappropriated in the next biennium's operating budget.

Incorporated in 1912, Redmond is the sixteenth largest city in the state of Washington encompassing an area of 16.85 square miles east of downtown Seattle on the east side of Lake Washington. Redmond has grown from a population of 1,453 in 1960 to a 2004 population of 46,900.

Factors Affecting Financial Condition

Information presented in the financial statements is best considered in the broader context of the economic environment in Redmond and the surrounding area.

Local Economy

Redmond has evolved from a small town with logging and farming as its chief industries into a city of high tech and light manufacturing, business parks, and a large outdoor mall adjacent to the downtown retail core. Much of this growth has occurred in the past twenty-five years. Redmond has become an employment center for many new and growing companies with Microsoft, at over 24,000 employees, the largest employer in the city. Other employers with a significant presence in the city include United Parcel Service, Genie Industries, Group Health, and the Lake Washington School District, headquartered at Redmond Town Center. The number of people employed by businesses operating in Redmond increased 4.3% from 2003 to 2004 to a total of 61,156.

Redmond remains a coveted place to live and work. A strong residential housing market fueled by low interest rates has caused a boom in single family housing starts in Redmond with average home prices increasing 16% from March 2004 to March 2005. While commercial development has slackened off some from the rapid growth years of the late 1990's, new and expanding businesses continue to choose Redmond as a desirable location. The Marriott Hotel opened a seven story, 262 room hotel in Redmond Town Center in the summer of 2004 bringing guests to the hotel and customers to the surrounding businesses at Town Center and the downtown retail area. Several retail businesses, Petco, Big Picture, and Gold's Gym among others, opened in 2004 and Whole Foods Grocery plans to open a large new store in Redmond in 2005. In addition, Microsoft and Nintendo have recently solidified their presence in Redmond with the filing of development review plans which allow for substantial expansions of their campuses and employment over the next twenty years. Redmond's strong, diversified

economic environment, educated labor force and attractive physical location make it a great place to raise a family and expand a business. Redmond has continued to value its unique natural environment despite the changes brought about by twenty-five years of rapid growth. The result is a community whose economic base is high technology and light industry, and where neighborhoods, parks and businesses fit together.

Long-term Financial Planning

Redmond is in a continuous process of both short-term and long-term financial planning. Short-term financial planning is inherent in the development of the city's biennial budget. Concurrent with the biennial budget, the city's long-term capital needs and potential funding sources are assessed. In recent years voter and state approved initiatives have limited the city's ability to increase revenues. Property tax increases are limited to a maximum of 1% per year or inflation, whichever is lower. The State Legislature, after pressure from constituents and special interest groups, approved legislation limiting the State's ability to collect motor vehicle taxes which in turn eliminated this source of state shared revenue for Redmond. In light of these revenue curtailments to fund city operations, the City Council has embarked on a project to develop a sound long-term financial strategy to fund city services and capital needs. Some of the funding options that have emerged from the early strategic planning sessions include voted bond issues for parks and transportation, and a voted property tax levy lid lift.

Redmond is also in the process of updating or developing several master plans to create a vision for the city that can be realistically implemented. The city's Comprehensive Plan was updated with amendments related to land use to encourage vibrant residential and mixed use developments. The next section of the Comprehensive Plan due for update is the Natural Environment element of the Plan. The Shoreline Master Plan was adopted in 2004 and work continues on the Transportation Master Plan (TMP) with public open houses and roundtables to gather input from Redmond residents. The goal of the Transportation Master Plan is to create a long-term, practical, and affordable transportation system that will serve all current and future Redmond residents. The TMP will serve as a blueprint for transportation planning, construction, programming, and financing for the next two decades.

A significant project currently underway in Redmond is the City Campus Project to address the shortage of work space for city staff. The city entered into a financing arrangement in April 2004 to build a new City Hall that will consolidate staff from six buildings to one building,

providing more centralized and efficient services to citizens. Construction began in August 2004 with occupancy scheduled for December 2005. City Hall was designed to be a water efficient, environmentally advanced building.

Redmond's parks are highly appreciated and well used by citizens and visitors alike. Several of the city's parks are sports centered with athletic fields, golf, and cricket venues for the citizens' enjoyment. Trails are an important part of the city's park system and work is underway on the Bear and Evans Creek Trail and Greenway system with completion of Phase 1 scheduled for 2005. This trail system is part of a loop of trails around the city. Funding for Parks capital projects is provided by a mixture of bonds, grants, taxes and impact fees with city officials and staff continually on the lookout for creative ways to augment these standard funding sources.

Transportation improvements are ongoing throughout the city with the widening of both Union Hill Road and the Redmond Fall City Road as two major projects currently underway. The Union Hill Road project will complete a five lane roadway section along approximately one mile of Union Hill Road with sidewalks and bike lanes to accommodate many modes of travel. The Redmond Fall City Road widening project is being done jointly with the State of Washington Department of Transportation who is managing the project. The city is also partnering with Sound Transit to build a transit center in Redmond. Transportation projects are currently funded with general tax revenues, business tax revenues collected specifically for transportation improvements, impact fees, grants and developer contributions.

As Redmond moves forward, economic indicators will be continually monitored and adjustments to city spending and services made to maintain the city's financial health. At the same time, long-term plans are focused on ensuring an economically strong and viable city.

Cash Management

The City invests only in securities authorized by State law, and primarily purchases certificates of deposit and obligations of both the U.S. Government and government sponsored agencies. As stated in the City's investment policy, the primary objectives of investment activities are safety, liquidity, then yield.

The safety of the City's investment portfolio is provided through the diversification and quality of investments

purchased, as well as the use of a delivery-versus-payment method for settlement of any transactions. To further ensure the safety of the City's investments, all securities are held and transactions processed by the custodial agent, Union Bank of California.

Liquidity is maintained by attempting to match investment maturities with cash flow requirements, limiting maturities to five years for general operating funds, and keeping a balance in the Local Government Investment Pool sufficient to meet short-term obligations. The Local Government Investment Pool is a state-managed account, which provides local governments with an efficient way to invest short-term and offers almost immediate cash availability. It operates similarly to a commercial money market account.

Yield is considered after safety and liquidity requirements have been met. The City's yield objective is to obtain at least a market rate of return. The basis used to determine whether market yields are being achieved is a comparison between the two year average of the two year Treasury Note and the average rate of return on the City's portfolio.

Risk Management

The City's Risk Manager develops and implements risk management policies and programs to establish a clearly defined risk management structure. The primary goal is to control the City's risk exposures and losses in order to protect the City's financial resources, ensure employees, citizens and visitors a safe environment in which to work and live, and to reduce the cost of insurance. As part of this goal, self-insurance is currently utilized as an alternative to conventional insurance in the areas of health care, Workmen's Compensation and establishing the deductible for property losses. The Risk Manager considers available financial resources and purchases insurance for appropriate excess protection. The Risk Manager also serves as a general advisor to all departments on risk management issues such as identifying and evaluating potential risks, providing employee accident control training, loss reporting and addressing City Safety Committee concerns.

Other Information

Independent Audit

State statute requires an annual audit by the Washington State Auditor's Office. The auditor's opinion letter on the general-purpose financial statements is included in the financial section of this report. The complete auditor's report is available at the Redmond City Clerk's office.

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Redmond for its Comprehensive Annual Financial Report for the fiscal year ended December 31, 2003. This was the nineteenth consecutive year that the government has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current comprehensive annual financial report continues to meet the Certificate of Achievement Program requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

Acknowledgments

The preparation of the Comprehensive Annual Financial Report on a timely basis could not have been accomplished without the efforts and dedication of the staff of the Finance Department. I would like to express my appreciation to my staff and other personnel from various departments and agencies who assisted in its preparation. Also, I would like to thank the Mayor and the City Council for their continued interest and support in planning and conducting the financial operations of the City in a dedicated and responsible manner.

Respectfully submitted,

Lenda Crawford
Finance Director